



Boston's Chinatown Gate



**City of Boston
Auditing Department**

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December 19, 2003

***The Honorable Mayor and
Members of the City Council:***

We are pleased to submit to you the Comprehensive Annual Financial Report (CAFR) of the City of Boston (City) for the fiscal year ended June 30, 2003. The accuracy of the financial statements together with the completeness and fairness of their presentation are the responsibility of the City's management. The enclosed data is accurate in all material respects and all disclosures necessary have been included to fairly present the financial position of the City. The financial position and results of operations of the various funds have been prepared in accordance with generally accepted accounting principles (GAAP), as established by the Governmental Accounting Standards Board (GASB). All requirements of State finance law of the Commonwealth of Massachusetts and the City Charter have also been satisfied.

The City of Boston composes this Letter of Transmittal to provide additional information to the readers of the Comprehensive Annual Financial Report. This narrative overview and analysis of the financial activities of the City of Boston is for the fiscal year ended June 30, 2003. Readers are further encouraged to consider this information in conjunction with the information that is supplied in the Management's Discussion & Analysis (MD&A) Section of the City's Basic Financial Statements.

This report is presented in three sections: (1) the Introductory Section includes general information about the City and summarizes financial activity for the fiscal year; (2) the Financial Section includes the Independent Auditors' Report on the City's Basic Financial Statements, MD&A, the Basic Financial Statements, the Combining and Individual Fund Financial Statements and Schedules for the various funds including required supplemental information; and (3) the Statistical Section includes financial data, debt computations, and a variety of demographic, economic and supplemental statistical information concerning the City.

In addition to the Basic Financial Statements of the City, this report includes information pertaining to component units included in the City's reporting entity because of the significance of their operational and/or financial relationship with the City as required by GASB Statement No. 14. The State-Boston Retirement System (SBRS) has been presented as a blended component unit because it provides services almost exclusively to the primary government. Discretely presented component units are reported in a separate column to emphasize that they are legally separate from the City, but are included because the City is financially accountable for and is able to impose its will on the organizations. The following component units have been discretely presented in the Basic Financial Statements: Boston Public Health Commission,

Thomas M. Menino, Mayor
Sally D. Glora, City Auditor

Boston Redevelopment Authority, the Trustees of the Public Library of the City of Boston, and the Economic Development Industrial Corporation.

Economic Conditions and Outlook

The City of Boston is the economic hub of both the Commonwealth of Massachusetts and the New England region. It is a center for professional, business, financial, higher education and medical services as well as transportation, communication, export, cultural and entertainment activities. Boston is also the state capital and the host to several federal agency offices. High technology, tourism, research and development, manufacturing, and wholesale distributions also contribute to the economy of the City and its suburbs. The City's economy continued to perform reasonably well despite the economic slowdown started in Spring 2001.

The financial markets continue to express their confidence in Boston's fiscal health. The credit ratings: Moody's Aa2, Standard & Poors's AA- and Fitch AA-, were reaffirmed in February 2003. Factors contributing to the confidence in Boston are its dominant role in the New England economy, the established track record of effective financial management and the City's continued conservative debt management and capital planning.

Overview of Local Economy

In Spring, 2001, Boston's nine-year economic expansion came to an end as an economic slowdown took hold. The number of jobs in the City reached an all-time high in the year 2000. Data from 2001 through September 2002 revealed employment losses. Although unemployment has risen since early 2001, the City's rate remains slightly lower than the nation's average as of June 2003. Boston's diverse economy is made up of financial and business services, research and development, health care and higher education, tourism and retail trade. Boston's housing market remained strong in 2002 and 2003 primarily because of low interest rates. Office, hotel, and tourism segments of the economy have shown slowing tendencies, although higher education and hospitals have continued to realize growth.

Employment

The calendar year 2002 annual unemployment rate for the City reached 5.8% compared with Massachusetts's unemployment figure of 5.3%. The nation's rate was 5.8%. Most recent data for June 2003 shows Boston's seasonably unadjusted unemployment rate at 6.4%, above the 5.7% rate for Massachusetts, but slightly better than the 6.5% rate for the nation.

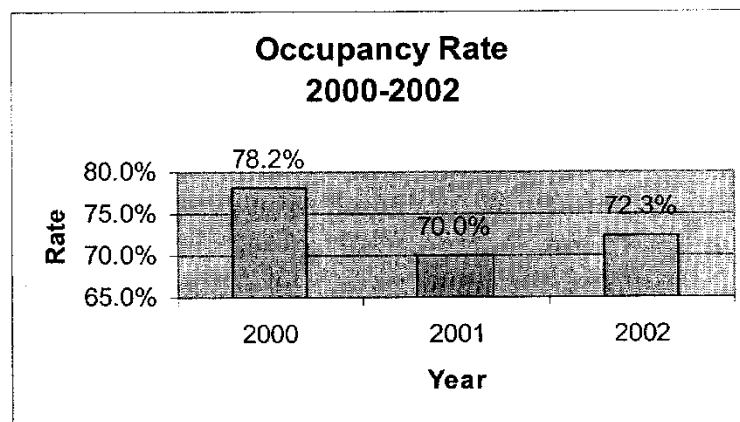
Commercial Office Market

In Spring, 2003, Spaulding & Slye, a local real estate broker, reported the vacancy rate at 10.6% and an availability rate of 17.7% when space for subletting was included. The office market is in its third consecutive year of recession. Compared with many other major cities' office markets, Boston has fared much better than most. Boston had the fourth lowest office vacancy rate of the top twenty markets according to CB Richard Ellis, an Office Vacancy Index.

In 2001 and 2002, ten major downtown office projects, with 4.0 million square feet of new office space, were completed. As of January 2003, six major downtown office projects with 2.8 million square feet of new office space are under construction and scheduled for completion sometime between 2003-2004.

Hotel Market

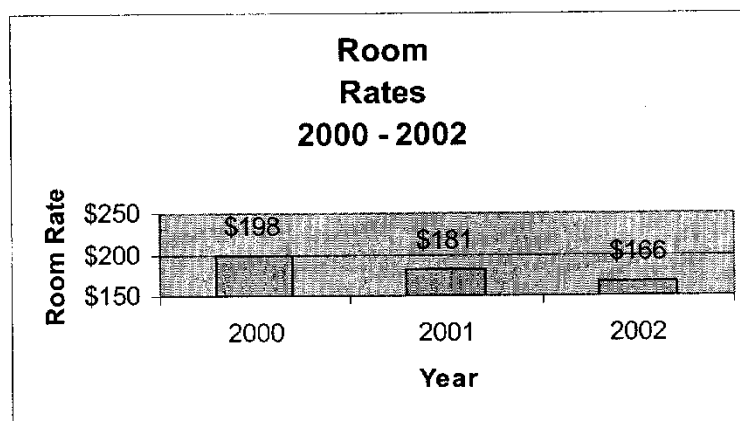
Boston's hotel market, which has been one of the nation's strongest, suffered from the economic slowdown, but occupancy rates did climb back in 2002. Below is a comparison of the most recent data from 2000 through 2002:



Source – Boston Redevelopment Authority

After a 3.1% increase from 1999 to 2000, the rate in 2001 declined by 8.2%.

Between 2001 and 2002 the occupancy rate climbed back by 2.3%



Source – Boston Redevelopment Authority

Per Diem room rates also took a fall as a result of the economic slowdown, finishing at

\$181 in 2001 and \$166 in 2002.

Hotel room construction has added 4,191 rooms from July 1997 to March 2003. An additional 914 rooms will be added with the completion of four newly renovated hotels currently under construction. Eighteen additional hotel projects have either received approval or have filed for approval with the Boston Redevelopment Authority (“BRA”). If built, there is potential for another 5,682 rooms.

Housing Market

Throughout the City there were 8,255 residential sales during the first eleven months of calendar year 2002, a rise of 11.0% from 2001. Median prices for an existing single-family home escalated from the fourth quarter in 2000 to the fourth quarter in 2001 by 21.8%. Prices for a single-family home during 2002 (through eleven months) averaged \$319,206. Prices for a condominium averaged \$307,146 for the same time period.

Areas with the largest numbers of single-family homes include West Roxbury, Dorchester, Hyde Park, and Roslindale. Median single-family prices ranged from a low of \$184,950 in East Boston to a high of \$1.3 million in Boston Proper (North End, Waterfront, West End, Beacon Hill, Back Bay, Fenway, Kenmore, and the South End) with the citywide median at \$319,206. West Roxbury, with a standard house price of \$334,900, is the most suburban-style single-family neighborhood within the city limits. Single-family home sales were up by 7.0% between 2001 and 2002.

Median condominium prices in the City ranged from a low of \$118,900 in Hyde Park to a high of \$381,500 in Charlestown. The citywide median sales price for condominiums was \$307,146. In Boston Proper, the area of the City containing the most condominiums, median prices were second highest in the City at \$363,000. Citywide, condominium sales were up 19.0% from the previous year and prices were up 10.0%.

Retail Market

Retail markets remain strong. There are now 21 neighborhood business districts selected for the Main Streets Program, which is a public-private initiative of the City, established in 1995 to revitalize neighborhood commercial districts through locally established organizations. During calendar year 2002, it generated 51 new and expanded businesses, created 260 new jobs, and provided for 57 storefront improvements. Through calendar year 2002, the Main Streets Program generated \$236,982 in public sector investment. This came in the form of physical improvement grants, which in turn leveraged an additional \$1.9 million in private investment.

The Target Corporation announced plans in the summer of 2003 to replace the recently closed Kmart in the South Bay Mall in Dorchester. Additionally, a Shaw's supermarket has recently opened near the Prudential Center in the Back Bay.

Active Construction Projects

Fiscal 2003 building permit revenues were reported at \$20.1 million for the year. This represents an increase of \$1.0 million or 5.2% change from the \$19.1million reported in fiscal 2002.

The Boston metropolitan area continues to be the site of several major public sector projects including the depression of the Central Artery and the construction of a four-lane tunnel under Boston Harbor. During the peak construction years from 1998 through 2001, it was estimated that transportation projects have employed approximately 5,000 on-site workers and 10,000 auxiliary workers. The completion of these projects is expected to occur in 2005.

In January 2003, Massport projected that it would spend about \$1.25 billion during fiscal years 2003-2007 for ongoing capital improvements to Hanscom Field, Logan Airport, the Tobin Bridge, Port facilities, and for improvements and major maintenance at various other Massport properties. Logan International Airport is undergoing a major modernization. Improved walkways, new roadway signage, and major terminal renovations are among the planned changes. A 3,150 car-parking garage and a 600-room hotel are complete and operational. Construction continues on a double-decked roadway system at the airport.

The Massachusetts Water Resources Authority ("MWRA") is planning to spend an estimated \$1.40 billion over the next ten years on water and wastewater system improvements. The largest expenditures will be for the Walnut Hill Water Treatment Plant to improve water storage facilities and reductions in combined sewer overflows. Small areas of these improvements are located in Boston proper, but are expected to provide major improvements in the infrastructure that serves the City.

The Boston Housing Authority ("BHA") recently completed major revitalization initiatives at two of its public housing developments: Mission Main, in the Mission Hill neighborhood of Boston, and Orchard Park in Roxbury. The BHA was able to initiate the revitalization of these developments when it was awarded two HOPE VI grants from the U.S. Department of Housing and

Urban Development ("HUD"). Not only did the initiatives revitalize the BHA sites, but the surrounding neighborhoods as well. Moreover, in September 2001, HUD awarded the BHA a \$35.0 million HOPE VI grant to redevelop the Maverick Gardens housing development in East Boston. Maverick Gardens' HOPE VI award will be supplemented by other public and private financial sources for a total project cost of \$145.0 million. Furthermore, a grant of \$5.0 million, also from HUD, will allow the redevelopment of a longtime vacant public housing building in Jamaica Plain. The building, located at 80-90 Bickford Street, will become 56 one-bedroom apartments for elderly residents. Finally, a joint venture between the Haley House and the Madison Park Development Corporation submitted the winning proposal to assume ownership, management and renovation of four BHA properties in the South End. The BHA tentatively designated the partnership as developer and future owner of its properties at 282 Columbus Avenue, 68 West Concord Avenue, and 564 and 688 Massachusetts Avenue.

The City and the Massachusetts Convention Center Authority ("MCCA") are in the process of constructing the Boston Convention and Exhibition Center ("BCEC") on a 60-acre site on Summer Street in the South Boston Seaport District. The 1.6 million square-foot facility, expected to open for operations in fiscal year 2004, will include approximately 516,000 square feet of contiguous exhibition space on one level, 160,000 square feet of meeting space and a 41,000 square-foot ballroom on other levels, as well as banquet and lecture halls. The BRA was authorized by the Convention Center Act to acquire and prepare the site for the BCEC Project. The MCCA is responsible for the design and construction of the BCEC project, and its operation upon completion.

In addition to the BCEC, the MCCA is undertaking the development of a convention center hotel on the northeast corner of the BCEC Project site. After a public bidding process, a team composed of Starwood Hotels and Carpenter & Company was selected in November 1999 to be the operator and developer of the on-site hotel. The developer has signed a development agreement with the MCCA and made a substantial deposit as part of the agreement. While preliminary work on the hotel project, such as design and permitting, has proceeded, construction was delayed as the developer sought financing for the project. The hotel's developer announced progress in the financing process in early 2003.

Tourism

The Greater Boston Convention and Visitors Bureau ("CVB") estimated that 12.9 million domestic and international visitors visited the Boston metropolitan area in 2002, up by 2.4% from the 12.6 million visitors in 2001. The latest data on the effects of the economic impact of tourism from the Massachusetts Office of Travel and Tourism shows that, for the five county region of greater Boston, an estimated \$7.50 billion was spent on hotel accommodations, meals, entertainment, shopping, transportation and other services during 2001. The latest data for Suffolk County indicates that in the county alone, the total domestic direct traveler impact in 2001 was \$4.71 billion. This figure supports 56,020 jobs and a payroll of \$1.60 billion while generating \$131.0 million in state tax receipts and \$82.0 million of hotel room tax receipts.

Boston is an attractive destination for conventions and meetings. In 2003, Boston is projected to host over 300 events – meetings, conventions and expositions – including a total of fifteen citywide conventions. These are defined as events that would each use over 2,000 hotel rooms on the peak night, which usually requires a minimum of three hotels. In November of 2002, the Democratic National Committee signed an agreement to host the 2004 Democratic Party Convention at the Fleet Center in Boston in July of 2004. Also, after a five-year term in New York City, the annual east coast Mac World Computer Show agreed to return to Boston beginning in the summer of 2004.

Future Economic Outlook

Boston started the year 2003 with signs of a slowing economy, continuing from early 2001. The Boston economy peaked in the 1999-2000 time period as Boston's office, hotel, and housing markets were among the strongest in the nation from mid-year 2000 into early 2001. From January 2001, signs of economic slowing had been notable and persistent through early 2003. Although these trends persisted in early 2003, they have modulated recently and are expected to improve in the near future. Two areas of the economy that have held up have been the housing market and consumer spending. Although residential sales have slowed recently, prices continue to rise. Consumer spending has also held up and has improved recently. The low interest rates of the past year have played a large role in the housing market and in consumer spending levels. The low interest rates are likely to continue into the near future, favorably impacting housing and consumer spending. The most recent economic indicators, at the state level, also suggest that Massachusetts's economy is beginning to grow again. Employment reports from the Commonwealth for the months of April, May, and June 2003 show jobs being created again and the nations financial markets posted gains in the second quarter of 2003.

The following is an excerpt from a recent report (June 2003) of the New England Economic Project (NEEP), a group of economists from each of the six New England States that track and forecast economic conditions in New England, on the outlook for the Massachusetts economy: "The recession is about over, but be patient! Employment will continue to decline for the rest of the year, but at a more moderate pace. Incomes should grow throughout the rest of the year (they appear to have declined in the first quarter), but by less than the rate of inflation. Real incomes should begin to grow early next year. By mid next year, the Massachusetts economy should be in a solid recovery mode, but growth over the next several years is expected to be much more moderate than in the 1990's."

Major Initiatives

Thomas M. Menino, Mayor of the City of Boston, was re-elected in November 2001 to a third four-year term, expiring in January 2006. The Mayor remains committed to promoting his initiatives in the areas of public education, public safety, housing and neighborhood development as well as economic development.

Public Education

The mayor, two years ago, issued an executive order to give City employees time off to get to know the Boston Public Schools ("BPS") during School Preview Time. School Preview Time is part of "Countdown to Kindergarten", a collaborative effort among the BPS, other City departments, and numerous community organizations to help children prepare for school and help parents prepare to be partners in their child's education.

The City, together with many of the area's largest philanthropic institutions and corporations, started Boston's After-School for All Partnership in 2001. Each partner has made a specific commitment to invest substantial funds in after-school and summer initiatives. The commitments total \$24.0 million over a five-year period. To date, the partnership has raised \$8.0 million from the private sector. This translates to serving 2,500 youths in vital programs to help working parents.

Efforts continue to reform our schools. Boston is the first major urban public school district to have every school connected to the Internet. The student-to-computer ratio is 5:1. Computers and technology have become more accessible to youth, as a result of a new technology initiative called Kids Compute 2001. Additionally, \$250.0 million from various funding sources is being invested in technology, schoolyards and schools.

Boston is the only school district in the country singled out with a renewal grant from the Annenberg Foundation. The Foundation has awarded Boston a second grant of \$10.0 million for innovative programs in individual schools. The Foundation is a ten-year effort to meet literacy requirements to better prepare students for graduation and continuing education. Unlike the first \$10.0 million grant, the second grant awarded in 2001, which runs through 2006, has no matching requirements. The grant is actually awarded to the Boston Plan for Excellence, a local school foundation. The Boston Plan for Excellence administers the grant in conjunction with the City's school district.

The BPS has a long-running tradition of working with numerous independent organizations to help bring additional resources, expertise and guidance to the youth of Boston and BPS students. Today, Junior Achievement's K-12 programs are serving more than 4,000 students in 46 Boston area schools and Boston after-school programs. In addition, over 500 Boston students participate in JA's annual Job Shadow Day initiative. For the Technology Initiative, over 100 businesses have contributed in the form of direct partnerships with the schools and other forms of system-wide assistance. Read Boston was launched five years ago. This literacy campaign continues to tutor children in reading every week with the assistance of 1,500 volunteers. Concurrently, the Write Boston program, with an effort to further improve Massachusetts Comprehensive Assessment System ("MCAS") scores of Boston's students, is geared to writing skills and proficiency in all grades.

The Federal administration's "No Child Left Behind" policy, established during the cyclical reauthorization of the Elementary and Secondary Education Act, promises resources

geared toward improving the quality of education for every child. "No Child Left Behind" funds come with substantial new programmatic requirements. Its major concepts are to improve parental involvement, flexibility for states and districts, accountability, and scientifically based instructional strategies and academic content.

In March 2003, the mayor officially launched Achieve Boston, a new collaboration among professionals in the after-school and youth development fields. Achieve Boston was started with seed money from the City and the federal Department of Education. This coalition seeks to improve the quality of after-school and youth programs by ensuring that staff has access to training and educational opportunities in their chosen field. Achieve Boston represents a collaboration among the Boston 2:00-6:00 After-School Initiative, the Medical Foundation, the Boys and Girls Club of Boston, the National Institute on Out-of-School Time Parents United for Child Care, and the YMCA of Greater Boston.

Public Safety

As noted in the most recent edition of the BPD Annual Report: "the Department employs a staff of just under 3,000 civilian and sworn personnel, and administers a budget of \$220.3 million to effectively police a daytime population estimated at approximately 2.0 million people. It does this in an area encompassing 48 square-miles of vibrant urban and residential neighborhoods, 785 miles of roadway and a number of harbor islands. It fields a fleet of over 800 vehicles from 25 facilities to respond to an estimated 500,000 calls for service each year, which are often received in dozens of different languages."

Over the past eight years, the Bureau of Professional Development of the BPD coordinates the Citizens Police Academy. A two-session course, citizens are educated and informed on areas including homeland security, terrorism defense, use of force and internal affairs.

The City has developed an Emergency Response Guide, entitled "Terrorism: A Community Response", the guide provides information on how to identify and prevent a terrorist threat, create an emergency plan and supply kit for each family. Also, the PHC has prepared a similar guide entitled, "Live. Learn. Prepare". It contains valuable information about how to cope with various terror-related emergencies. Both guides are available at local libraries, community centers, supermarkets, public stations, and online.

Housing and Neighborhood Development

The City cannot solve its housing crisis without a commitment from the federal government. The HOME Investment Partnership Program is an entitlement grant from HUD to support the development of affordable housing. Boston expended \$4.6 million in this program in FY02 and \$7.8 million in FY03. Eligible activities include new construction or rehabilitation of housing, tenant-based rental assistance for up to two years, and assistance to first-time homebuyers. All HOME funds are used to benefit low and moderate-income households. Fifteen

percent of HOME funds are set aside for projects sponsored by Community Housing Development Organizations and 5% are set aside for their operating costs.

Annually, HUD administers four federally funded grants to the City. The Emergency Shelter and Housing Opportunities for Persons With Aids ("HOPWA") grants are entitlement grants that become available in July of each year. The Shelter Plus Care grant program provides rental assistance for homeless people with disabilities, primarily those with serious mental illness or chronic substance abuse problems. The Supportive Housing Program provides service, operating and/or capital funds for a broad range of housing and social service projects. Expenditures for these four programs in FY03 amounted to \$17.3 million, while another \$19.6 million is expected to be available in FY04.

The Neighborhood Improvement through Capital Expenditure Program ("NICE") is the City's neighborhood-driven capital investment program for small projects on City-owned property. Through cyclical selection rounds, communities have the opportunity to propose ideas for specific projects/physical improvements that enhance the public spaces in their neighborhoods. Representatives appointed by the mayor from various City departments will review qualified applications from the public. With recommendations being forwarded to the Department of Neighborhood Development ("DND"), projects are rated for feasibility and merit through threshold and selection criteria including cost, long-term maintenance issues, degree of community support, and the impact of a project on the neighborhood.

Another major economic and community development initiative is the "Leading the Way" program. Leading the Way, the City's multi-year strategy for addressing the City's affordable housing issues, lays the groundwork for the City to accomplish its goal to create more affordable housing. To meet the goals set forth in Leading the Way, the City is combining existing programs with new resources and initiatives. The City has committed \$33.0 million in City resources to accomplish this program. In FY03, the City appropriated the final \$3.0 million dollars that completes this commitment.

An ongoing housing initiative sponsored by DND is Homeworks. Homeworks helps Boston homeowners make affordable home improvements. The program is available to those homeowners who meet the income requirements. The goal is to assist lower-income homeowners with their home improvement projects and provide them with financial and technical assistance. To be eligible for Homeworks, one must be an owner/occupant of a one-to four-family house or condominium unit.

Economic Development

Public and private investments in entertainment and infrastructure are providing additional revenue and future growth for the City and its residents.

Numerous economic development initiatives are being undertaken by the BRA to ensure the continued economic prosperity of the city. One major economic development initiative is the Back Streets Program. Boston's Back Streets Program strives to help the City's small-and

medium-sized industrial and commercial businesses by creating conditions in which they can grow and prosper. Back Streets program initiatives are to support the growth of Boston's Back Streets businesses through the preservation of industrial space, help Boston's Back Streets companies find, train and develop workers, make Boston an attractive, hospitable place to do business and to bring new and existing resources to Back Streets businesses.

Ten percent of the City's population resides in the area designated as the Empowerment Zone ("EZ"). The population of this area has an unemployment rate of 16.1%, and 43% of adults over the age of 25 have less than a high school diploma (These figures are as of the 1990 Census). Goals of the EZ include: job creation, business development, home ownership opportunities, affordable housing creation, transit system improvements, computer technology training, and job training and educational efforts.

Section 108 Loan Project funds are available to eligible cities from HUD on an application basis. The Economic Development Initiative Program ("EDI") is a special HUD program that makes grants available to cities to spur economic opportunity. EDI grants must be used in conjunction with Section 108 Loan funds. In September 2002, HUD awarded the City \$0.5 million for the EDI and the Main Streets Programs. The City secures these funds, which can only be used for economic development projects. The City received a multi-year grant of \$22.0 million to be used in conjunction with \$22.0 million in Section 108 Loan funds for use within the EZ.

Other

Effective July 1, 2002, the Mayor merged the City's Human Service functions into one department named Boston Centers for Youth and Families ("BCYF"). BCYF is the consolidation of Boston Community Centers, the Mayor's Office of Community Partnerships, the Boston 2:00 -6:00 After-School Initiative, and the Recreation Division of the City's Parks and Recreation Department. Through its five core program areas, BCYF provides one-stop shopping for families looking for programs and resources for infants to elders. Its goal is to provide education and recreation programs that are both enriching and fun at quality public facilities in every Boston neighborhood.

The Mayor's Office, in FY02, organized key staff from the four Cabinets that comprise the Mayor's Energy Management Board (Environmental Services, Basic City Services, Finance, and Public Health Commission) for a cooperative, interdepartmental approach to comprehensive energy management planning. To meet the Mayor's goal of reducing the City's energy consumption by 10% by 2005, staff members have been working hard to raise funds through grants from state and federal agencies, as well as working closely with local utility companies to take advantage of efficiency programs and technical assistance. Major initiatives for the coming year include: the development of an energy accounting system to ensure that the City is accurately monitoring and controlling its energy use, using that system to identify where the City can achieve the greatest energy savings, and identifying the potential for citing renewable energy sources on City property through a grant from the Massachusetts Technology Collaborative.

In addition to the City's work on municipal energy use, the Green Building Task Force was formed. This will examine how private sector development in Boston can increase the use of high performance building techniques in new and retrofitted construction. This includes energy efficient lighting and equipment, recycled building materials, and renewable energy sources. The BRA and the Environmental Services Cabinet are the major players for this task force.

The Neighborhood Jobs Trust invested \$1.7 million in FY03 toward the "First Steps" program. This program supports 18 community organizations that provide training in office computer skills, healthcare, and culinary arts. Neighborhood Jobs Trust also provided "seed money" for the English for New Bostonians Initiative. With their support, there are now 400 more seats available for English classes.

In an effort to reduce the workforce while minimizing layoffs, the Mayor offered two retirement incentives in FY03. In Spring, 2002, the Mayor announced an Early Retirement Incentive ("ERI") for interested employees to retire as of October 31, 2002. Caps initially placed on the number of employees to be accepted into the program were lifted. Employees were awarded an additional five years towards retirement, to be taken in age, service or some combination of both. This effort, along with placing strict controls on back filling positions, resulted in a total net decrease of 480.5 full-time equivalents ("FTE's") reported from January 1, 2002 to January 1, 2003.

The second incentive was a Voluntary Retirement Incentive ("VRI") for interested employees to retire as of June 30, 2003. Employees who took advantage of this incentive and did retire by June 30, 2003 were awarded a 20% bonus on salary. The net effect of this incentive, as well as the City's continued efforts to control all hiring, will be reported in January 2004.

With personnel costs and health benefits representing 74% of the City's operating budget appropriations, reducing the employee levels is necessary. Thoughtful restructuring of government must continue in order to mitigate the impacts on services during these challenging times.

Current Projects

Government Effectiveness

A number of innovative steps to improve traditional functions of City government have been undertaken by the Administration. Departments and Cabinets are constantly challenged to rethink existing programs, improve service delivery and pursue new opportunities and partnerships. Boston About Results ("BAR") was unveiled in FY03. Under BAR, financial and operational performance is monitored on an ongoing basis via monthly revenue and expenditure variance reports to ensure accountability for performance.

The Police and Fire Departments are continuing efforts to implement positive change. Management continues to negotiate with collective bargaining units to work to improve

contractual language that will allow opportunity for increased productivity and the ability to create efficiencies.

The Boston Administrative Information Systems ("BAIS") are citywide integrated applications for financial and human resources management, supports the timely and accurate reporting of data. BAIS positions City managers to be responsive to controlling staffing and budgets throughout the fiscal year. The BAIS Asset Management application has been updated to ensure compliance with GASB 34 requirements effective for FY03 reporting. The "Workflow" process is used to relieve a paper-intensive procurement process and address documentation of receipt of goods and services. The BAIS Support Program set the stage in FY03 for the upgrade of the Financial applications scheduled to be in production in November 2003. Web based financial and human resources management applications position the City to further its use of technology in initiating best business practices.

The City's Auditing and Management Information Services ("MIS") departments have worked to produce the City's annual financial statements on-line. The Basic Financial Statements and the Comprehensive Annual Financial Report ("CAFR") for FY02 and FY03 are featured on the City's web page (www.ci.boston.ma.us/auditing). On line access to these reports offers easy timely access to information and reduces costs.

Public Education

In November 2002, voters approved Massachusetts Ballot Initiative Question 2. This mandates that, with limited exceptions, all public school children in Massachusetts must be taught all subjects in English. During the year, the School Committee approved the Policy for English Language Learners ("ELL"). This policy remains in place with modifications that take into consideration the legal requirements of Question 2. The phase-in process continues in areas such as definition of programs, student and teacher assignments, and professional development. The Office of Bilingual Education and Language Service ("OBELS") has redefined its mission to achieve a balance between focusing more deeply and more systematically on the academic achievement of English Language Learners and compliance monitoring. OBELS is a project-based City organization designed specifically to execute all aspects of Question 2 from research to implementation.

Faced with increasing fixed costs and an uncertain economic environment, the BPS took several aggressive measures in order to balance its FY04 budget and preserve its long-term fiscal health. These steps included eliminating approximately 1,000 budgeted positions, trimming Central Office budgets by 26% and closing five schools.

Even with a challenging budget development process, the BPS was able to present a balanced budget focused on our teaching and learning agenda, including funding for critical areas such as: opening three new state-of-the-art schools; building on our progress in high school restructuring and creating small learning communities; purchasing textbooks and instructional materials to support the implementation of English immersion; sustaining the gains made in student academic achievement and closing the achievement gap.

To prepare students for life and work in the 21st century, it is essential that they have access to technology to support their learning. In November 2001, the Mayor and the Superintendent of Schools launched the Learning and Information Network for the Community ("LINC2"), BPS' second five-year technology plan. A major initiative of LINC2 is the development of MyBPS, an Intranet portal for improved communication within the entire BPS community, including teachers, administrators, students, and families. LINC2 articulates the use of technology to support Focus on Children II. Other goals of LINC2 include the completion of the networks and electrical upgrade of all schools, and the ability to provide professional development so that all teachers will be able to use technology thoughtfully to support student learning.

BPS is the beneficiary of a consortium of higher education institutions. According to the Boston Higher Education Partnership, 28 colleges and universities have formed a consortium that provides the largest amount of funding and services to a single urban school district in the entire country. This steadily increasing assistance comes in the form of scholarships, pro bono assistance, and external grants.

The English for New Bostonians Project is a private-public four-year, \$4.0 million partnership with several Boston foundations and corporations formed in 2000. The goal of this partnership is to reduce Boston's English as a Second Language waiting list for adults while improving the capacity and the quality of ESOL classes of current providers.

Public Safety

Close collaboration with numerous local, state, and federal law agencies, as well as cultivation of an extensive network of ongoing partnerships throughout the community, have combined to make the Boston Police Department ("BPD") a regional and nationally recognized leader among its peers. Innovative efforts in areas such as youth violence prevention, domestic violence prosecution, and customized data analysis capabilities have also contributed to significant reductions in violent crime during recent years, culminating in a 31-year low in 2002.

The BPD's award-winning Neighborhood Policing strategies continue to pay dividends throughout the City. The Department's primary focus remains squarely on high-impact crime-reduction and prevention efforts. At the same time, its growing domestic preparedness responsibilities play an increasingly important role in how it delivers superior public safety services to Bostonians, as well as many of their neighbors throughout the metropolitan area.

Another important key for BPD has been its ability to coordinate its long-term strategic planning efforts in order to maximize the impact of its state-of-the-art equipment, facilities, and training. Such planning has enabled the Department's leadership to decentralize many aspects of its command structure in order to address diverse quality of life concerns that are unique to specific neighborhoods. The success of programs such as Operations Cease Fire and NiteLite helped BPD to target and eliminate repeat violent offenders citywide. Now the lessons learned from these

programs are also helping the Department to create a next generation of highly successful initiatives such as the offender Re-Entry Program, and the Unsolved Shootings Project.

Traffic safety is the focus of the Neighborhood Policing strategies of the Boston Police Department, the traffic calming initiatives of the Transportation Department and the "Walk This Way" pedestrian safety program coordinated by the Public Health Commission ("PHC"). In fiscal 2002, the City earmarked \$300,000 to install new school zone traffic signals at crosswalks and intersections around schools.

The Police Department's grant funding at both the federal and state level has focused mostly upon adding police officers and community policing. "Same Cop Same Neighborhood" is a policing program based on the belief that police officers and private citizens working together can help address community problems related to crime. Having the same officer patrolling the same neighborhood every day, results in the officer knowing the community and its residents better. The program, supported with a grant awarded by the Massachusetts Executive Office of Public Safety, has received a total of \$4.7 million in FY03. For FY04, the Department anticipates funding of \$4.0 million available for this program.

Additionally, the BPD, in coordination with the District Attorney's Office and other law enforcement agencies, will put new squads on the streets in the City's most crime-impacted neighborhoods to focus exclusively on unsolved shooting incidents and unlawful gun use.

The federal government's First Responder Initiative awarded \$3.50 billion to cities and towns for homeland security efforts. The City was allocated \$16.7 million of this funding in April 2002. In addition, the federal agency of Homeland Security delivered an additional \$31.0 million to the Commonwealth, earmarked for equipment and training for those who would be "first responders" in the event of an attack. Boston's share was \$2.0 million.

As a result of the recent fire tragedy in Rhode Island in February 2003, the Mayor signed an Executive Order banning pyrotechnic displays in the City's 210 licensed nightclubs and has called for a task force to examine the City's related safety regulations. The task force will examine issues of nightclub safety, including education and occupancy. City public safety officials will sponsor a mandatory seminar to inform and educate nightclub owners about public safety regulations. Per statute, nightclub personnel will be required to conduct a daily sweep of exits prior to opening. The Mayor's Office of Consumer Affairs and Licensing, as part of a nightclub's annual renewal, will require additional life-safety training.

Housing

In November 2002, the City and FleetBoston Financial announced a new \$22.0 million Boston housing program called Three Decker Plus. Three Decker Plus is the result of collaboration among DND, FleetBoston Financial and the Massachusetts Housing Partnership. This new and unique pilot initiative helps make the purchase of a three-decker home in Boston affordable to low and moderate income first-time homebuyers. In exchange for the financial

assistance, the buyer will agree to rent one unit at affordable rates for 20 years. The City will assist with closing costs and down payments.

The Community Development Block Grant ("CDBG") is a sizable annual entitlement grant from HUD to the City of Boston designed to fund a variety of neighborhood development activities. The City expended approximately \$29.3 million in CDBG funding in FY02 and spending was at \$30.1 million in FY03. Estimated spending of CDBG funds for FY04 is \$28.5 million.

Other Projects

Boston Main Streets is currently participating in "Wanted: Solutions for America", a two-year national research initiative documenting and disseminating ways to build stronger communities. The Pew Partnership, a civic research organization located in Charlottesville, VA, directs this initiative. It is funded by the Pew Charitable Trusts, a national and international philanthropy based in Philadelphia, PA. The initiative is based on the premise that communities across the nation have developed solutions to our country's most intractable issues such as housing, job creation, access to healthcare and that these can be collected and shared across the nation.

Despite the fiscal and economic slowdown that many municipalities are enduring, Boston's future is still bright. Currently, the City has 77 development projects worth \$4.30 billion under way. The Longwood Medical Area is ripe with possibilities, and the 27 acres of green space being restored by the Big Dig provides Boston with the unique opportunity of becoming a truly world class city.

In fiscal year 2002, Boston developed an ongoing partnership with Fleet Bank. Fleet Bank is working with the City to create a \$1.0 million revolving loan program so low-income families can purchase home computers. This effort shows the bridge Boston is building to help families and young people learn the skills they need to improve their lives.

Future Projects

Capital Plan

The City's 2004-2008 Capital Plan proposes new long-term investments over the next 5-7 years, as well as several studies to lay the groundwork for future growth. In total, over \$1.20 billion of City and non-City sources of funds have been proposed to be spent on capital projects. These expenditures will be used for improvements to schools, public safety, libraries, parks and recreation, roads and bridges, community centers, technology upgrades, public health and environmental initiatives. In view of the proven economic and social benefits of consistent, long-range capital planning, the City remains committed to moving forward with its capital program.

The Police Department's Capital Plan includes authorized funding for the construction of a new neighborhood station in the South End and renovations to the West Roxbury station. The Fire Department will be purchasing a new fire radio system and has undergone fire station repairs in 2003.

Prompted by the events of September 11, the Fire Department will revise its training plans, obtain and issue additional equipment and improve incident command systems to respond to any new threats to the City. As a result, a Special Operations Command has been created to more efficiently operate, train, equip and staff Hazardous Materials, Rescue, Confined Space, SCUBA and Marine services.

The BPS Capital Plan includes the completion of external construction for 3 completed schools, which opened in the spring of 2003; masonry repairs at 20 schools; roof replacements at 5 schools; construction and installation of modular classrooms facilities at 2 schools; the design of full electrical and technology wiring upgrades at 29 schools and the construction and renovation of 15 schoolyards and the design of another 8 schoolyards. These items are highlights of school projects and are accompanied by a wide assortment of maintenance projects for schools including window replacement, roof maintenance, boilers and HVAC systems. Included in these school renovations are a new gymnasium, cafeteria, and expanded library at Burke High School and upgraded science laboratories at Brighton High School.

The BPS is committed to the expansion of Tech Boston Academy. Tech Boston Academy, founded by the Bill and Melinda Gates Foundation in FY02, is a new technology high school that prepares students for careers as engineers, programmers, and technicians. The high school served 74 students in FY03, all in grade 9. In FY04, grade 10 will be added serving an additional 80 students.

Capital investment continues to support the City's commitment to efficient, effective municipal management by building a physical infrastructure that is strong and adaptive. Substantial investment has been made in capital improvements, technological advances, and equipment for maintenance programs to improve safety conditions, decrease operating costs and provide better service delivery. Total capital expenditures in FY04 are forecast at \$103.0 million. The total includes \$65.0 million for general obligation bond spending, \$16.0 million for new school construction and \$22.0 million from capital grants.

Economic Development Activities

The BRA has released the Seaport Public Realm that describes the development of the over 1,000-acre South Boston waterfront area. The BCEC is the keystone of the seaport development and is expected to attract thousands of new visitors and millions of new dollars into Massachusetts each year. It will serve as a catalyst for the development of new hotels in the area. The South Boston Waterfront will be a destination for workers, residents and visitors. Areas have been identified for cultural facilities, parks, and gateways to Boston Harbor and the Islands.

A variety of other studies are planned to enhance economic development activities. Included are Boston 400, a citywide comprehensive master planning process to determine infrastructure investment and economic development for this century, the central artery air rights planning study, a turnpike air rights planning study, a transit-oriented development study, and neighborhood plans for the Fenway, East Boston, the Fort Point District, Jackson Square, North Allston, Roxbury and the West End.

With 51% of the City's real estate being off the property tax rolls, controlled by tax-exempt institutions, there will be a new era of partnerships with the City's colleges, universities, and nonprofits. Boston will work with these institutions to create scholarships or help unemployed workers learn new skills to get a better job. Preliminary discussions with Harvard University have been initiated to expand its medical school complex to Crosstown in Roxbury. This would not only strengthen the neighborhood, but also create more jobs.

The BRA has selected MDA Partners LLC to redevelop Hayward Place on lower Washington Street with a mixed-use retail and office building. The plan will create a twelve-story building that includes 350,000 square feet of office space and 40,000 square feet of retail. The developers will pay the City \$23.0 million, of which \$10.0 million will support housing development and \$13.0 million is intended for the Quincy Upper School. The Haywood Place development is expected to bring in roughly 3,000 new visitors to the area. Linkage funds of \$2.5 million will be paid to the City.

Looking ahead, the BRA has approved plans for 723 units, and projects for 406 units are under review for a total of 1,129 units.

Other

Due to the economic downturn, the City's summer job funding was slashed by close to \$3.0 million and in jeopardy of leaving numbers of teens without a summer employment opportunity. However, faced with this "crisis" situation, the Mayor recruited the private sector for assistance. Announced in June with a program start date in July 2003, Boston received commitments from area colleges, companies and foundations. This made it possible for the City to support additional summer jobs for Boston teenagers this year.

The Massachusetts Executive Office of Environmental Affairs has given the City a grant of \$1.6 million to build about 750 new monitoring wells. The funds will be released in three installments, with \$0.5 million made available immediately, \$0.5 million made available in FY04, and \$0.6 million for FY05.

Service Accomplishments

One in four Bostonians was born in another country. Collectively, more than 100 languages are spoken by Bostonians. Lack of English proficiency is a common barrier for many new immigrants. This past year, "English for New Bostonians", a public-private partnership, was

introduced. In fiscal year 2003, this program, with the help of businesses and community organizations, served 620 students with a retention rate of 79%.

“Leading the Way”, a three-year comprehensive strategy to increase and protect Boston’s housing supply, laid the groundwork for the City to accomplish its goal to create more affordable housing. The program allowed for the creation of 7,500 new housing units, preserved 5,342 affordable rental units and made 1,000 City-owned lots available for development, cutting the number of abandoned homes across the City by 50%.

According to a survey conducted by the Beacon Hill Institute at Suffolk University, a conservative research group, of the nation’s 50 biggest cities, Boston rates as the third most economically competitive city for FY03. Boston tops all U.S. urban regions in “human resources” as measured by unemployment and education, and technology as gauged by science and engineering activity. Theft and murder rates are among the lowest in the country.

Continuing the effort of improving Boston’s vehicular transportation and infrastructure, the Leonard Zakim Bunker Hill Bridge and the underground Interstate-93 tunnel system opened in March 2003. The 10-lane, 180-foot wide bridge will carry traffic on Interstate-93 across the Charles River. The bridge’s north tower is 330 feet above the ground, while the south tower rises 295 feet above ground. The obelisks atop the two inverted Y-shaped towers resemble the nearby Bunker Hill Monument.

Thanks to the efforts made in “Focus on Children”, Boston’s five-year plan has been a great success. Across the board, MCAS scores have risen by 18%. Nearly 70% of students go on to college. Relative to graduation rates, Boston ranked fourth in the nation in FY03.

BPS received major grants of \$7.5 million from the National Science Foundation grants, \$8.0 million from the Carnegie Foundation, and \$10.0 million for a challenge grant from the Annenberg Foundation. These grants were in use during FY03 and are earmarked for use over the next nine years.

In the last eight years, Boston invested more than \$270.0 million through the City’s capital plan to renovate its schools. FY03 also saw \$25.0 million invested to build three new Early Learning Centers. The City saw a major improvement in its computer-to-student ratio going from 1 computer for every 63 students to 1 computer for every 5 students. Over 4,000 of the City’s 4,789 teachers have received at least 50 hours of training and are using technology in the classroom.

The BPS completed an aggressive, three-year mathematics development plan that began with the 2000-01 school year. The Math Development Plan was designed to improve all students’ math knowledge and skills to ensure their success on the MCAS and the Stanford 9 exams.

Several major parks projects were completed this spring. The Parks and Recreation Department performed a major refurbishment of Christopher Columbus Park and the installation of artificial turf fields at Joseph Moakley Park and English High.

Since its inception in 1995, the Boston's Main Street's Program has developed in 21 neighborhood business districts: 3,057 storefronts have been either restored or renovated, 506 businesses have received design assistance and more than 3,000 jobs and 444 new businesses have been created. Main Streets has leveraged more than \$7.9 million in private investment.

In November 2002, the Mayor launched the Back Streets program – a new initiative that focuses on Boston's commercial and industrial businesses. This initiative falls under the BRA's jurisdiction. The goal of Back Street is to stimulate the economy, strengthen our neighborhoods, and create more jobs for the people of Boston. There are more than 4,000 Back Street companies in the City. Together, they provide more than 100,000 jobs. This translates to 1 in 5 jobs in Boston comes from this sector of the economy. Also, loan limits have been raised from \$150,000 to \$250,000.

The City's workforce development continues to show positive results. In FY03, Boston put the new Federal Workforce Investment Act to work. As a result, 360 people received the skills and training they needed and 84% of the graduates are now employed in jobs related to their education. Many workers who received training now have jobs averaging 115% of their previous salary. Also, Boston's three career centers, the Workplace, Boston Career Link and JobNet, helped 10,000 jobseekers and 2,000 employers.

As a result of statistical data compiled in March 2003, the American Podiatric Medical Association honored Boston as one of the nation's top 10 most walk able cities.

In April 2003, the Allston Branch Library was rededicated as the Brian Honan Allston Branch Library. The library is named in honor of the late, young City Councilor who had such a profound impact on the Allston-Brighton community; the new library consists of 20,000 square feet. Included are a children's reading room, a courtyard garden and an "information highway" that contains reference materials, computers and stacks. The building will also have a meeting room and conference room that is available for use when the library is closed.

The City is proud of its focus on contribution to improving the quality of life and education as well as the strength of the Boston economy. While the City is proud of its accomplishments, it recognizes the need for continual change to meet the needs of Boston citizens and its economy.

Accounting System and Budgetary Control

The accounts of the City are organized on the fund basis. Each fund is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts, which comprise each fund's assets, liabilities, fund balance,

revenues and expenses. An integrated computerized financial accounting system is maintained by the Auditing Department to record transactions within these accounts. This system is an encumbrance accounting system, which monitors the City's purchase orders for goods, services and other contractual commitments. The City budgets and maintains its books and records on a statutory basis of accounting prescribed by the Commonwealth of Massachusetts. This basis of accounting differs from accounting principles generally accepted in the United States of America.

The City's management is responsible for establishing and maintaining internal accounting controls designed to provide reasonable, but not absolute, assurance that the assets of the City are safeguarded from loss, theft or misuse. In addition, the internal control structure reasonably assures that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles excepted in the United States of America. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management. The City Auditor is responsible for evaluating the adequacy and effectiveness of the control structure, and the Auditing Department conducts a periodic evaluation of the control structure's effectiveness.

As a part of its internal control structure, the City maintains budgetary controls. The objective of these controls is to ensure compliance with the legally mandated budget adopted by the City Council. Activities of the General Fund are included in the annual budget. The budget within the Special Revenue Fund is established based on specific grant requirements or specific legislation, but is not subject to City Council approval. The Capital budget reflects long-term needs financed primarily through the issuance of bonds. This multiyear plan is subject to approval by the City Council. Specific budgets are established for each capital project prior to its inception.

The function and activity within the individual fund establishes the level of budgetary control. Budgetary control in this context defines the level at which expenditures cannot legally exceed the appropriated amount. In the case of the General Fund, this control is at the department level. In the case of the Special Revenue and Capital Projects Fund, the control is at the grant or project levels respectively. All of these budgetary controls reside within the City's financial system and are monitored by the Office of Budget Management and the Auditing Department to ensure compliance.

The Auditing Department initiates a fiscal year closing process that limits and controls departmental appropriation reserves through encumbrances and closely monitors the amount of prior year reserves carried forward. The process allows for the year-end closing and accompanying financial statements to be completed in an efficient and timely manner.

The Federal Single Audit Act requires the City to have an annual independent audit conducted on the federal financial assistance it has received. This audit is conducted simultaneously with the City's annual financial statement audit.

A significant portion of the Single Audit work is devoted to evaluating the City's internal control structure. The evaluation includes tests of a significant number of individual federal grant transactions that occurred during the fiscal year. The Single Audit work also requires that the auditors determine whether the organization has complied with laws and regulations that may have a material effect on each of its major federal financial assistance programs. All of the City's major federal programs are evaluated for the adequacy of internal controls and compliance with laws and regulations.

The City's Single Audit report for the year ending June 30, 2003 included no instances of material weaknesses in the internal control structure, nor was any significant violations of the applicable laws and regulations reported. The report is publicly issued under a separate cover. In addition to the annual audit of the federal financial assistance programs, the City also identifies specific grants received from the State for compliance and internal control review by the independent auditors.

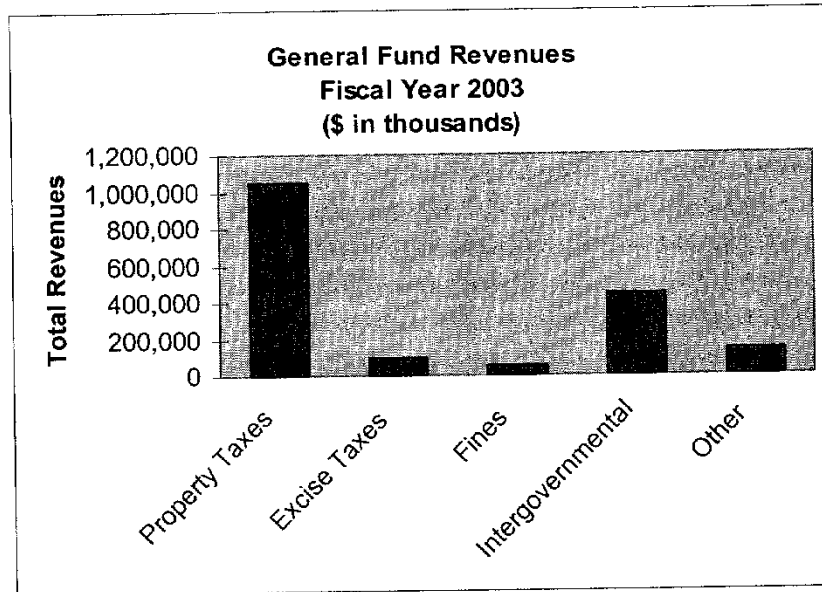
Governmental Activities

The City of Boston, incorporated as a town in 1630 and as a City in 1822, now exists under Chapter 486 of the Acts of 1909 and Chapter 452 of the Acts of 1948 of the Commonwealth of Massachusetts, which, as amended, constitute the City's Charter. The Mayor is elected to a four-year term and serves as chief executive officer of the City. The Mayor has general supervision of and control over the City's boards, commissions, officers and departments. The legislative body of the City is the City Council, which consists of thirteen elected members serving two-year terms.

The following sections include selected financial data reported on a GAAP basis. Presented are the operations of the General Fund, Special Revenue Fund, Capital Projects Fund, Other Governmental Funds and Internal Service Fund as well as Fiduciary Funds administered by the City.

General Fund

The general fund is the main operating fund of the City accounting for the revenue received of over \$1.79 billion. The major sources of funding are presented below:



Comparative General Fund Revenues

Revenues	GAAP Basis (\$ in thousands)		2002	%	Inc (Decr)	% Change
	2003	%				
Property Taxes	\$ 1,053,945	58.7%	990,848	55.0%	63,097	6.4%
Excise Taxes	94,133	5.2%	111,114	6.2%	(16,981)	-15.3%
Payments in Lieu of Taxes	40,910	2.3%	36,332	2.0%	4,578	12.6%
Fines	59,187	3.3%	60,601	3.4%	(1,414)	-2.3%
Investment Income	8,951	0.5%	14,596	0.8%	(5,645)	-38.7%
Licenses and Permits	30,217	1.7%	33,325	1.9%	(3,108)	-9.3%
Department and Other Revenue	62,373	3.5%	62,200	3.4%	173	0.3%
Intergovernmental	444,751	24.8%	492,299	27.3%	(47,548)	-9.7%
	<u>\$ 1,794,467</u>	<u>100.0%</u>	<u>\$ 1,801,315</u>	<u>100.0%</u>	<u>\$ (6,848)</u>	<u>-0.38%</u>

Revenues

Revenue declined in fiscal year 2003 from fiscal year 2002. Every source of revenue declined except Real and Personal Property Taxes, Payments in Lieu of Taxes, and a slight increase in Departmental and Other Revenues. The largest dollar decline of nearly \$47.5 million occurred in

Intergovernmental Distributions as the State continued to reduced aid to municipalities. The decrease in Investment Income is the result of continued weak market performance and low interest rates, yielding poor returns on otherwise favorable cash balances. Fines decreased slightly (2.3%), due partially to increased compliance after parking fine amounts increased in early fiscal year 2003. Property Taxes increased \$63.1 million, or 6.4%, as a result of increased property values and new growth to the tax base. Payments in Lieu of Taxes increased partially due to the Massachusetts Port Authority's return to a normal payment amount after reducing its payment in the fiscal year 2002 and better than expected payments from Chapter 121A agreements with urban redevelopment corporations.

Expenditures

Changes from 2003 to 2002 are presented in the following table:

Comparative General Fund Expenditures

Expenditures:	GAAP Basis (\$ in thousands)					
	2003	%	2002	%	Inc (Decr)	% Change
General Government	\$ 53,343	3.0%	\$ 77,019	4.4%	\$ (23,676)	-30.7%
Public Safety	394,692	22.7%	405,844	23.4%	(11,152)	-2.7%
Public Works	86,819	5.0%	74,651	4.3%	12,168	16.3%
Property and Development	29,260	1.7%	48,774	2.8%	(19,514)	-40.0%
Schools	654,958	37.6%	627,653	36.2%	27,305	4.4%
Public Health Programs	63,897	3.7%	64,537	3.7%	(640)	-1.0%
Retirement Costs	74,720	4.3%	82,034	4.7%	(7,314)	-8.9%
Other Employee Benefits	114,512	6.6%	107,701	6.2%	6,811	6.3%
State & District Assessments	69,009	4.0%	67,769	3.9%	1,240	1.8%
Debt Service	121,184	7.0%	115,366	6.7%	5,818	5.0%
Other	77,465	4.4%	63,797	3.7%	13,668	21.4%
	<u>\$ 1,739,859</u>	<u>100.0%</u>	<u>\$ 1,735,145</u>	<u>100.0%</u>	<u>\$ 4,714</u>	<u>0.3%</u>

Overall fiscal year 2003 expenditures increased slightly from the previous year. Spending for Public Safety decreased \$11.2 million (2.7%) due to a cancellation of the cadet class for the Police department and the reduction in the summer jobs program. The increase in Public Works of \$12.2 million or 16.3% was the direct result of increases to trash removal and disposal fees and inclement weather during the winter months. Property & Development decreased \$19.6 million (40.0%). This was primarily due to the reclassification of the Community Centers program from Property and Development to Other expenditures. Schools increased \$27.3 million (4.4%) due to the Transition Program, and collective bargaining. Other Employee Benefits expenditures rose by \$6.8 million (6.3%). This resulted from increased costs of health insurance. Retirement Costs decreased by \$7.3 million (8.9%) as a result of receiving higher than projected revenue as reimbursements for Teachers' Retirements.

"Other" expenditures increased by \$13.6 million (4.4%). This category includes a dramatic increase in Human Services at \$18.3 million, due to the consolidation and transfer of services for youth and

families from Community Centers, 2:00 to 6:00 After School Initiative, The Office of Community Partnerships and the Recreation Division of the Parks and Recreation Department under the central control of a new department named Boston Center for Youth and Families. Changes in this category also include slight decreases in Parks and Recreation of \$1.6 million and Library at \$1.0 million, as well as a very slight increase in Judgments and Claims (\$0.1 million) and County (\$0.1 million).

Special Revenue Fund

The Special Revenue Fund is used mainly to account for the activities of the City that are funded by grants from the Federal and State governments. Revenues received from the Federal and State governments during 2003 decreased 7.0%. The decrease resulted from the City being awarded fewer new grants to help support education, after-school programs and public safety initiatives.

Expenditures in the Special Revenue Fund increased by \$8.2 million. This increase was primarily due to the defeasance of debt relating to the February 2003 General Obligation Refunding Bond Issue.

Capital Projects Fund

Capital projects fund is used mainly to account for construction activities of the City. These activities are primarily funded from bond proceeds or other external funding sources. Revenues for the Capital Projects Fund decreased by \$9.2 million to \$13.1 million in fiscal year 2003, mainly due to a decrease in grant revenues from the Commonwealth of Massachusetts. Expenditures increased by \$50.3 million to \$189.9 million for the period ending June 30, 2003. This can be attributed to an increase for the acquisition of land and buildings for City department use, located at 1010 Massachusetts Avenue, Boston, MA (\$31.6 million) and the one time payment of debt service relating to the January 2003 note payment (\$25.0 million). The City continues to be conservative in overall spending in the fund resulting in reduced spending in all other categories.

In 2003, the remaining major portions of capital spending focused on the construction of two new middle schools, one new K-8 school, and ongoing school building renovations. In addition, the Parks and Recreation Department and Public Works Department continued on their programs of refurbishing parks, playgrounds, and public ways.

Internal Service Fund

The Internal Service Fund accounts for the City's Health Insurance Trust Fund. Blue Cross/Blue Shield (BC/BS) acts as a third party agent for the City's employees, retirees and their dependents for payment of expenses incurred under various health indemnification plans utilized by the City. Costs incurred under the BC/BS plans are shared, with 25% paid by employees and retirees and 75% paid by the City. Operating revenues for the Internal Service Fund in 2003 were \$72.7 million and expenses totaled \$72.3 million. The fund balance at June 30, 2003 was \$7.9 million as compared to a fund balance of \$7.5 million at June 30, 2002.

Cash Management

The City's Collector-Treasurer establishes the investment policies of the City. Portions of Massachusetts General Laws Chapter 29 and 41 govern these policies. Generally, the City's investment policy centers on receiving a competitive yield for its investible cash while ensuring safety. The balances held in the City's General Fund for investment are ultimately used to meet liability obligations and, therefore, are not available for what would be considered long-term investing. The duration of time during which funds are available for investment does vary; therefore, the City must carefully select the investment type most suitable for the given time frame to optimize income while maintaining safety and sufficient liquidity requirements. The City requires that repurchase agreements, certificates of deposits and sweep vehicles will be collateralized

Additionally, the Collector-Treasurer working in tandem with the trustee(s) of the various trust funds has developed a detailed Investment Guidelines and Policy Statement for an individual or Common Fund. General Laws of Massachusetts Chapter 203 (Uniform Common Trust Act) provides that the City of Boston may establish common trust funds. The pooling of individual trust funds into a Common Trust allows for greater diversification of investment in asset classes, as well as reduced management cost.

Risk Management

The Risk Management Program focuses on a planned strategy of self-insurance supported by strong prevention and cost reduction efforts, financial reserves and catastrophic insurance. The City is self-insured in most areas of risk including general liability, property and casualty, workers' compensation, certain employee health care costs, and unemployment compensation.

The City's legal liabilities are capped per M.G.L. Ch. 258, and Corporation Counsel defends the City in any lawsuits that arise from the normal course of operations. For workers' compensation, the City is exempt from state insurance requirements per M.G.L. Ch. 152 s. 25B. The City's Workers' Compensation Division, and Police and Fire Departments manage employee injury claims internally. The City budgets and funds for legal claims and employee injury costs through the General Fund, charging specific departments for their share of costs in order to promote awareness and prevention efforts.

The City purchases health insurance coverage for employees and retirees through a number of health maintenance organizations (HMO's), in addition to also offering several self-insured indemnity plans, which are administered by Blue Cross and Blue Shield of Massachusetts (BC/BS). HMO costs are funded through the General Fund, and the self-insured plans are financially managed through a trust fund established in compliance with section 3A of Chapter 32B of the General Laws

For unexpected large losses, the City has been continually building a catastrophic risk reserve, which has an available balance of \$6.5 million at the end of fiscal 2003.

To further protect the City's assets and finances from adverse loss, commercial insurance is purchased strategically for certain exposures. A catastrophic property insurance policy provides \$30.0 million all risk protection after a \$20.0 million retention. Boiler and machinery losses are insured up to \$2.5 million per incident, after a \$50,000 deductible. Any losses related to the City's school busses are insured through the management contractor.

Fiduciary Operations

The City participates in a contributory retirement system, the State-Boston Retirement System (SBRS). The City is the largest member of SBRS, a cost sharing multiple employer public employee system operated under Chapter 32 of the Massachusetts General Laws (MGL) as amended by Chapter 306 of the Acts of 1996. The SBRS provides retirement, disability and death benefits to plan members and beneficiaries. Each participating employer's share of the total annual contribution is determined on the basis of active payroll.

The City is committed to funding based upon a schedule approved by the SBRS and the State actuary, which includes paying the current year's estimated present value of benefits earned during the year (normal cost) and an annual contribution toward reducing the unfunded liability to zero by the year 2023. The schedule is subject to update and approval at least every three years by the Public Employee Retirement Administration Commission (PERAC), a State agency established to oversee all 104 local Massachusetts public retirement systems. The annual appropriation, based on the approved funding schedule, is a legal obligation of the City that must be included as part of the tax rate certification by the Commonwealth of Massachusetts.

Cost of living adjustments are considered by the SBRS Board on an annual basis. As part of the annual review process, the Board considers the fiscal conditions of the City and whether the granting of the COLA would substantially impair the City's funding schedule. Cost of living adjustments are set each year at the CPI, or an amount up to but not greater than, 3% on the first \$12,000 of a retiree's annual payment. The Board approved a 3% COLA for 2003.

The City also operates the Boston Retirement System (BRS). BRS is the predecessor to SBRS and is closed to new members and is funded on a pay-as-you-go basis. The operations of BRS are not material to the City as a whole.

Other Information

Independent Audit

The Commonwealth of Massachusetts, through Chapter 190 of the Acts of 1982, requires that the City undergo an annual audit performed by a firm of independent public accountants. The City has selected the firm of KPMG LLP to perform the June 30, 2003 audit. This audit is conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. The audit provides an independent review to help assure a fair presentation of the City's financial position and results of operations.

The City also undergoes an annual audit of its Federal grant funds as required by the Single Audit Act. KPMG LLP issues separate reports on the City's internal control systems and compliance with applicable laws and regulations that meet the requirements of the Single Audit Act and Office of Management and Budget Circular A-133.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Boston for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2002. This was the eighth consecutive year that the City of Boston has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

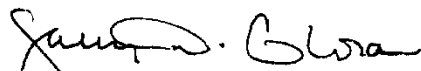
A Certificate of Achievement is valid for a period of only one year. We believe that our current report continues to meet the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, the City of Boston also received the GFOA's Award for Distinguished Budget Presentation for its Annual Budget document for the fiscal year beginning July 1, 2002. The City of Boston's budget document was judged to be proficient in several categories including policy documentation and financial planning.

Acknowledgements

We would like to express our appreciation to the staff of the Accounting and Financial Reporting Program and all the members of the Auditing Department staff whose professionalism and dedication made the timely preparation of the CAFR possible. We also wish to thank the professional staff of KPMG LLP for their counsel, technical assistance and encouragement in the preparation of this CAFR. Several other City departments and agencies provided additional information and assisted in the CAFR preparation. We gratefully acknowledge their efforts and contributions to this report. Finally, we wish to thank you for your continued interest in the financial operations of the City, and for the planning and support necessary to conduct the City's financial operations in a responsible manner.

Respectfully submitted,



Sally D. Glora
City Auditor

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Boston,
Massachusetts

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

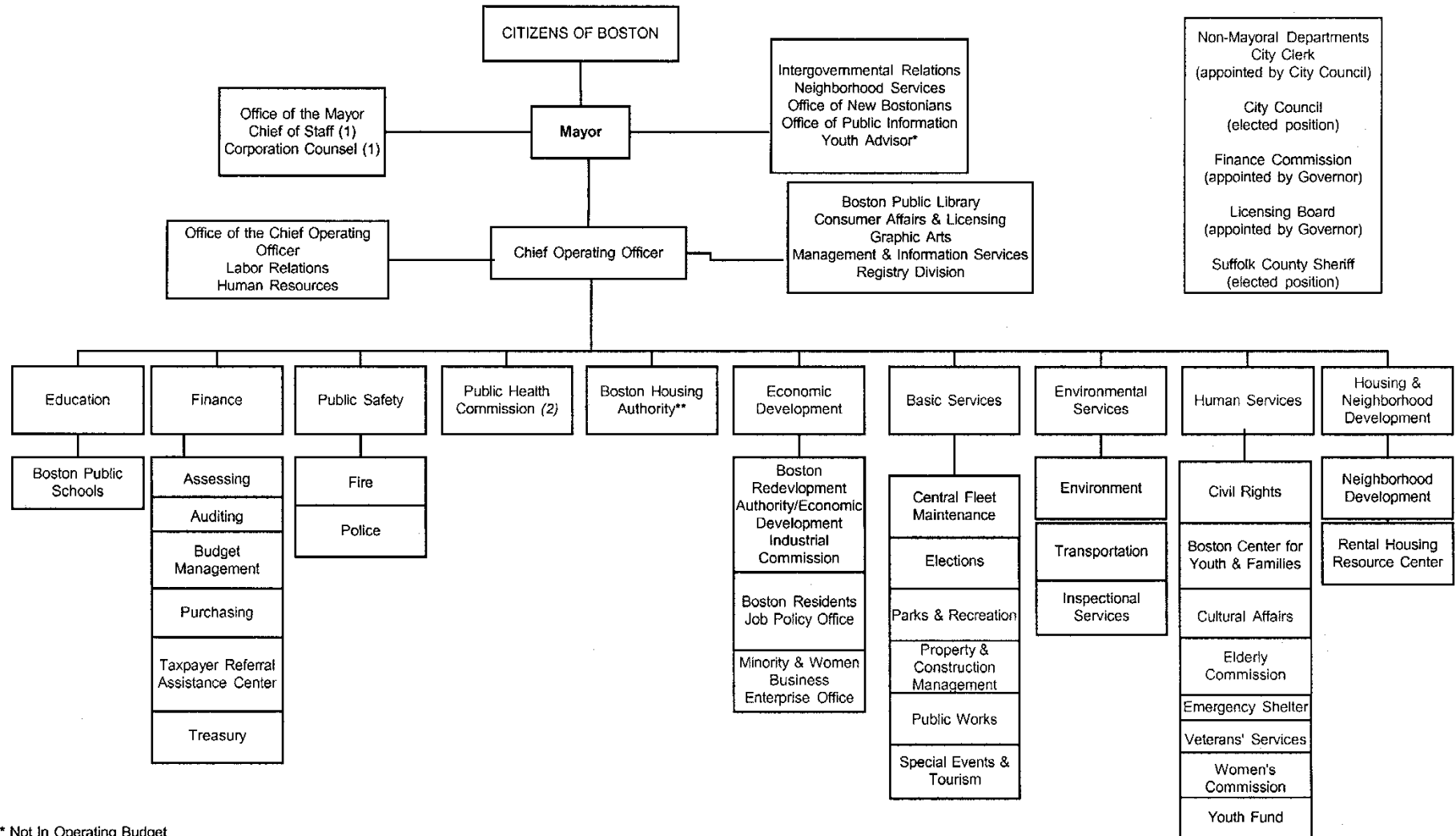
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

ORGANIZATION OF CITY GOVERNMENT



* Not In Operating Budget

** Not In Budget

(1) Has cabinet rank.

(2) The Boston Public Health Commission is an independent authority created in June 1996.

XXX

ELECTED and APPOINTED OFFICIALS

Mayor

THOMAS M. MENINO

City Council Members

Michael F. Flaherty, Jr.(President)	At-Large
Maura A. Hennigan	At-Large
Stephen J. Murphy	At-Large
Felix D. Arroyo.....	At-Large
Paul J. Scapicchio	District 1
James M. Kelly	District 2
Maureen E. Feeney	District 3
Charles C. Yancey	District 4
Robert J. Consalvo	District 5
John M. Tobin	District 6
Chuck Turner	District 7
Michael P. Ross	District 8
Jerome P. McDermott	District 9

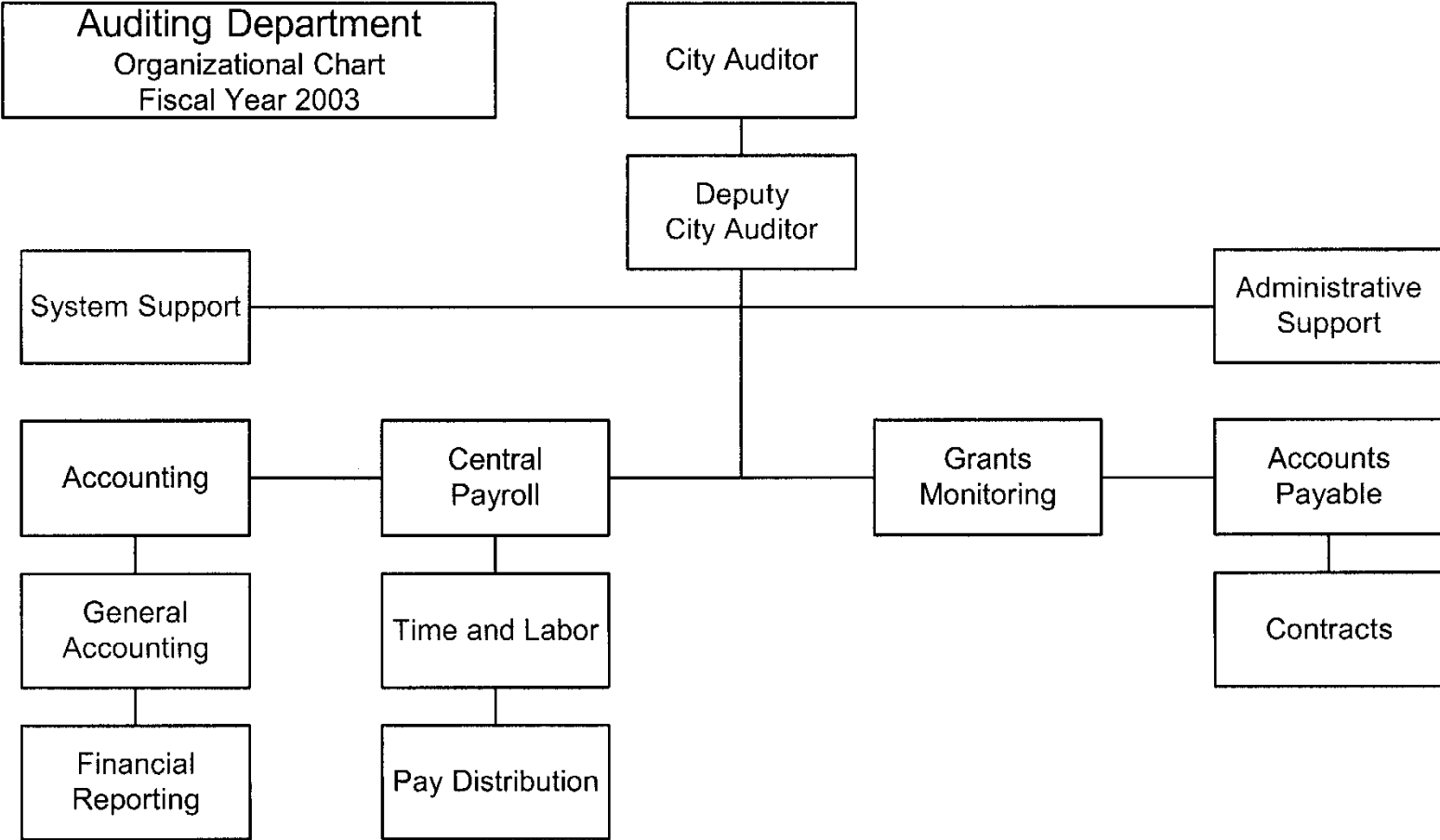
Suffolk County Officials

Andrea Cabral	Sheriff
Daniel F. Conley	District Attorney

Appointed City Executive Branch Members

William Holland.....	Director of Public Agency Relations
Dennis A. DiMarzio.....	Chief Operating Officer
Edward J. Collins, Jr.....	Chief Financial Officer and Collector-Treasurer
Mark Maloney.....	Chief Economic Development Officer
Thomas W. Payzant.....	Chief of Education
Juanita Brooks-Wade.....	Chief of Human Services
Michael Galvin.....	Chief of Basic Services
Andrea d'Amato.....	Chief of Environmental Services
Sandra B. Henriquez.....	Chief of Public Housing
Charlotte Golar-Richie.....	Chief of Housing
Paul E. Evans.....	Chief of Public Safety (Police Department)
Paul A. Christian.....	Chief of Public Safety (Fire Department)
Merita A. Hopkins.....	Corporation Counsel
John M. Auerbach.....	Chief of Public Health

Auditing Department
Organizational Chart
Fiscal Year 2003



Auditing Department Personnel

Sally D. Glora, City Auditor

Dennis J. Coughlin, Deputy City Auditor

Daniel Adam

Allan M. Brodsky

Domenica Cabral

Elvira Carnazzo

Michelle E. Castillo

Mattie Crouse

Allen Hurley

Cynthia Johnson

Robert Kollar

Linda Lockhart

Nelly Lopez

Medina Lucien

Mary C. Maiullo

Luis Carlos Martinez

Mary Ann Mason

Sheila A. McGonagle

Antonio Nunes

Diane O'Malley

Christine M. Opila

Michelle Pacitta

Charles T. Panagopoulos

Mary L. Raysor

Carol Rhodey

Magnolia Rojas

Christopher Sargeant

Lori Schilling

Lisa Stone

Ming C. Su

Donna Seel

Julie A. Tippet

Stanley J. Wallace

Paul F. Waple



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